

DEPARTMENT OF STATE REVENUE**LETTER OF FINDINGS NUMBER: 97-0181 ST
STATE GROSS RETAIL TAX
For Years 1994, 1995, AND 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES**I. State Gross Retail Tax – Imposition**

Authority: IC § 6-2.1-5-10; IC § 6-2.5-4-10; IC § 6-3-1-19; Indiana Gross Income Tax Division v. Musselman, 212 N.E.2d 407 (Ind. App., 1965)

Taxpayer protesting assessment of sales tax, taxpayer requesting proceeds be treated as income from joint ventures.

II. Tax Administration – Waiver of Penalty.

Authority: 45 IAC 15-11-4; 45 IAC 15-5-7(3); IC § 6-8.1-10-4

Taxpayer seeks waiver of the penalties because the tax liabilities were not due to fraudulent intent.

STATEMENT OF FACTS

Taxpayer's Indiana business consisted of renting, leasing, selling or otherwise providing amusement devices (gaming machines, dart games, jukeboxes, and video games) to taverns and service clubs within the state. The arrangements were to place amusement devices in the clubs and taverns with a verbal agreement between taxpayer and the owner to split the proceeds from the devices with the taxpayer keeping 50 to 60 percent of the proceeds. Taxpayer was arrested and charged with failure to pay sales tax. In a plea agreement charges related to illegal gambling were dropped and taxpayer plead guilty to a failure to pay sales tax charge. During the audit years, the taxpayer's business first

operated as a sole proprietorship, and was then incorporated. Sales tax was assessed based on records seized during the criminal investigation indicating amount of income received, a blank copy of a lease contract for the amusement devices, two Business Tax Application forms, and a sales tax return for one month without sales tax payments remitted with the filing. Taxpayer declined to answer requests for further information during the audit. During the appeal process, taxpayer indicated he had paid use tax on the purchase of the amusement devices and reported the income on his personal tax return.

I. State Gross Retail Tax – Imposition

DISCUSSION

Taxpayer was assessed state gross retail tax based on IC § 6-2.5-4-10; defining a retail merchant to include a person “making a retail transaction when he rents or leases personal property to another person.” This determination was based on the information that was provided or available related to the taxpayer’s business activities.

Taxpayer argues that the transactions should be treated as joint ventures based on Indiana Gross Income Tax Division v. Musselman, 212 N.E.2d 407 (Ind. App., 1965), which defined similar transactions as joint ventures rather than leases. While the facts are analogous, this case dealt with the gross income tax liability of a taxpayer who chose to consistently file as a joint venture and was denied by the State under the Gross Income Tax Act of 1933, a statute that has since been amended. As the court noted:

“...it appears to this Court that the application by the Gross Income Tax Division of Instructions 4-29 and 4-175, which do not even tend to have the force of law since 1956, amounts to discrimination, as they concern two different groups of taxpayers occupying substantially the same legal relationships.” Musselman, 212 N.E.2d at 410.

The Indiana code presently defines a partnership to include joint ventures at IC § 6-3-1-19. IC § 6-2.1-5-10 states in relevant part:

Every individual, partnership, corporation, limited liability company, joint stock company, or association that is either a resident of this state or has a place of business in this state, shall file an information return with the department if he has the control or custody of, receives, or makes payment of:

....

(3) rents, premiums, annuities, compensations, or other fixed or determinable annual or periodic amounts, which are subject to the tax imposed by this article and must be reported by the taxpayer under federal income tax law;...

Taxpayer purports to have had 48 separate joint ventures, 17 in 1994, 18 in 1995 and 13 in 1996, and by the above requirements would have been required to file 48 IT-65 forms for these tax years. Taxpayer presents no evidence of any of the required filings.

Conversely, the filings by the taxpayer all support the concept of a lease arrangement. Taxpayer filed two Business Tax Application forms, one dated June 14th, 1995 and a second dated January 16th, 1996. One sales tax return was filed by taxpayer in December of 1995, but without payment remitted.

Taxpayer argues that payment of the use tax for the purchase of the amusement devices, which, if they were to be leased, was not required per the exemption given in IC § 6-2.5-5-8, supports the joint venture theory. While the exemption may be applicable, taxpayer, throughout the period of this audit, demonstrated a consistent absence of interest in state tax issues.

While taxpayer presents a credible argument that the business arrangements could have been treated as joint ventures, there is no supporting evidence that this was taxpayer's intention. When the auditor prepared an assessment on this income, the auditor made the tax determination on the information available. This information indicated a leasing arrangement was in place, both by the material available (the lease document, the Business Tax applications, and the filed sales tax return) and the absence of the 48 required partnership filings for a joint venture, which required a failure to file on both the taxpayer's part as well as the 17 separate businesses taxpayer dealt with over this three year period.

The actions of this taxpayer and those he conducted business with demonstrate a leasing arrangement, not a joint venture, was in force during the audit period.

FINDINGS

Taxpayer's protest is denied.

II. Tax Administration – Waiver of Penalty.

DISCUSSION

Finding the liabilities were due to taxpayer's failure to pay taxes with "the fraudulent intent of evading the tax" IC § 6-8.1-10-4. The Department imposed a one hundred percent penalty. "Fraudulent intent" is defined in 45 IAC 15-11-4, pertinently:

An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

Five elements are required by 45 IAC 15-5-7(3) to establish the taxpayer's actions as fraudulent, these items are:

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

Taxpayer made no informational filings as required for joint ventures, and only made one of the over 30 required monthly sales tax reports.

- (B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

The income generated was generated by retail sales, regardless of the theory by which the activity was organized. Taxpayer presents no evidence of any payment of the required sales tax, and taxpayer's knowledge of this requirement is evident from the filing, without payment, of a monthly sales tax return, and the two Business tax application forms.

- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

Taxpayer's failure to file either the required informational returns or the majority of the monthly sales tax returns caused the department to believe no, or very limited, retail sales were occurring.

- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

As was noted under deception, the taxpayer's actions prevented the department's assessment of the tax due.

- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

No tax was collected on the retail sales, thus the money which properly belongs to the state of Indiana was not paid.

Taxpayer operated a substantial business operation, incorporating and expanding the operation over the three years of the audit. All aspects of the business operation that are available indicate that taxpayer was a capable business operator who deliberately maintained an operation with minimal documentation of income and business arrangements. Taxpayer provides no evidence that his business's income was ever voluntarily reported, the tax was only assessed after the income amounts were discovered as part of a criminal investigation. Aside from arguing that the wrong tax was assessed against this income, taxpayer offers no explanation for the failure to report this business income under any theory or purpose, nor any evidence that any business tax was paid by any party allegedly involved. Taxpayer's actions were intentional and actual wrongdoing conducted over the three years covered by the audit, and the logical result of these actions was for the specific purpose of evading taxes on this income. Consequently, the fraud penalty is appropriate.

FINDINGS

Taxpayer's protest is denied.